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The Manufacturers Hanover
Financial Digest
Weekly Commentary, Selected Financial Data, and Business Indicators

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Rising Food And Energy Costs . . .

One of the most welcome developments accompanying the current economic expansion is the relatively low rate of inflation. Over the past 12 months, retail prices, as measured by the consumer price index (CPI), rose by only 3.6 percent. At the wholesale level, the producer price index (PPI) increased only 1.6 percent over the same period. But now, concerns over a newly rekindled inflation spiral are emerging, fueled by November's 0.6 percent month-over-month rise in the CPI and two consecutive large monthly jumps, 0.8 percent in November and 0.9 percent in October, in the PPI.

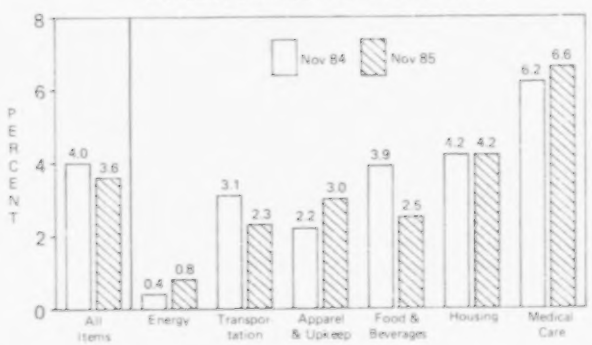
The 0.6 percent advance in the CPI was the largest rise in almost two years. It was double October's increase and triple that for each month from May through September. But this does not necessarily portend a major outburst of inflation. Higher food and energy costs were the main factors behind the recent advance in retail and wholesale prices and these increases are expected to be only short-lived. The impact of these two categories on the overall level of inflation can be seen by looking at a price index which excludes them. Without these two components, which account for almost one-third of the CPI, November's increase would be only 0.4 percent. For the PPI, the difference is even more dramatic, as the PPI excluding food and energy rose only 0.1 percent in November rather than 0.8 percent, month-over-month.

Food prices are probably of greatest concern to most people since about one-fifth of the average consumer's budget is devoted to purchases of food and beverages. Although this component was one of the largest contributors to November's uptick in inflation, it reflected volatility in livestock prices rather than a trend toward rapidly rising farm product prices. Meat prices in November rose 2.6 percent, compared with October, after falling in eight of the previous nine months. This rise was led by beef and veal prices, which rose 3.5 percent due to stepped-up slaughtering of herds earlier than usual this year as debt-strapped farmers tried to raise money to pay for spring planting costs.

. . . Do Not Spell . . .

Energy prices went up due to temporary shortages in gasoline and home-heating oil. These shortages were brought about by two factors. First, refiners had been keeping inventories of these products lean, anticipating that prices of crude oil would decline, and second, the early advent of severe winter weather in many parts of the country suddenly increased the demand for heating oil. Gasoline prices rose 1.4 percent in November, month-over-month, after dropping for four straight months, but home-heating oil prices rose a hefty 4.6 percent. However, neither food nor energy prices are expected to continue rising rapidly for long, given the general weakness in the farm economy and the recent declines in oil prices amid the disarray within the Organization of Petroleum Exporting Countries.

CONSUMER PRICE INDEX AND SELECTED COMPONENTS
(PERCENT CHANGE FROM A YEAR AGO)



In spite of the uptick in November, the 12-month increase in food and beverage prices is only 2.5 percent, well below the 3.9 percent jump posted in the previous 12-month period (see chart). For energy prices, the latest 12-month rise is 0.8 percent. While this is double the 0.4 percent gain in the previous 12 months, it is only a fraction of the double-digit increases seen in the early 1980s. Apparel and upkeep prices and medical care costs are increasing somewhat faster in the latest 12-month period than in the immediately preceding 12 months, while transportation costs are increasing more slowly and housing costs have risen at the same pace over these two periods.

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. . . An Early End To Low Inflation

One reason to be wary about the inflation outlook is the lower value of the dollar compared with foreign currencies, and its possible effect on the prices of consumer goods. Inflation trends in the two broad categories of consumer purchases, goods and services, are strikingly different (Financial Digest—October 28, 1985). The 12-month rate of rise in prices of goods—2.3 percent—has been running at less than half of the rate of rise in services' prices. The main reason for this difference is lower-priced imports due to the strong dollar and lower labor costs in many areas overseas. This has forced domestic goods producers to hold down price increases in order to be more competitive. Services are not generally imported and therefore, the providers of these services have not faced the same price competition.

But since its late February peak, the value of the dollar on a trade-weighted basis has dropped almost 25 percent. Using the rule of thumb that each ten percent reduction in the value of the dollar would increase the overall price level by about one percent within two years—as foreign product prices rise in terms of dollars, allowing domestic producers to raise prices—there is the possibility of an increase in the rate of inflation from around 3.5 percent to six percent throughout the next two years. This increase in inflation would reflect the rate of rise in

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit	12/25/85		
U.S. Gov'ts and Agencies Owned Outright & RPs	187.614	+ 1.086	+18.390
Loans to Depository Inst.	.948	– .053	– .896
Float	1.347	+ .210	+ .120
Total Reserve Bank Credit	204.576	+ 1.455	+20.572
Treasury Deposits with Federal Reserve Banks	3.577	– .199	– .092
Currency in Circulation	195.964	+ 1.204	+13.151
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	125.161	+ .774	+ 3.839
	12/18/85		
Member Bank Reserves:			
Total Reserves Held	45.983	+ .740	+ 6.367
Excess (Deficiency)	.841	– .197	+ .315
Net Free Reserves	.524	+ 1.911	+ .455

Monetary Aggregates†		% Change Since Three Months Ago*	% Change Since Year Ago
M1 (12/16/85)	622.6	+ 8.4‡	+ 12.2‡
M2 (November '85)	2,547.1	+ 5.3	+ 8.6
M3 (November '85)	3,194.4	+ 6.6	+ 7.9
Domestic Nonfinancial Debt (3rd Q'85)	6,523.1	+ 11.7	+ 13.7

†Seasonally adjusted.

* Seasonally adjusted annual rate.
‡ Four-week moving average.

New York Money Market

Offering Rates 1/3/86	3 Months	6 Months	1 Year
‡U.S. Treasury Bills	7.08%	7.11%	7.10%
* Federal Agencies	7.25	7.25	7.28
* Municipal Notes—High Grade (46% Taxable Equivalent)	10.37	10.00	10.65
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market—Prime	7.77	7.75	7.75

‡Finance Company Paper—Prime		‡* Bankers' Acceptances	
5- 14 days	7.75%	Feb.	7.80%
15- 29 days	7.75	Mar.	7.70
30- 59 days	7.80	Apr.	7.60
60- 89 days	7.65	May	7.55
90-179 days	7.62	Jun.	7.50
180-239 days	7.60	Jul.	7.45
240-270 days	7.60		

‡Industrial Paper—Prime			
30- 89 days	7.70%	†Federal Funds Effective Rate	8.30%
90-120 days	7.55		

‡Discount basis. * Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	3rd Q'85	$ 4,017	$ 3,961	$ 3,812
Gross National Product (1982 Dollars)*	3rd Q'85	$ 3,584	$ 3,557	$ 3,510
Percent Change, Annual Rate	3rd Q'85	3.0	1.1	2.1
Change in Consumer Prices*	Nov '85	7.2%	3.6%	2.4%
Change in Producer Prices*	Nov '85	9.6%	10.8%	3.6%
Civilian Employment (Thousands of Persons)†	Nov '85	107,927	107,867	105,932
Unemployment as % of Civilian Labor Force†	Nov '85	7.0%	7.1%	7.1%
Personal Income*	Nov '85n	$ 3,345	$ 3,326r	$ 3,184r
Leading Indicators Composite Index (1967=100)†	Nov '85n	171.5	171.3r	165.1
Industrial Production Index (1977=100) †	Nov '85	125.1	124.6	123.4
Net Change in Consumer Installment Credit †	Oct '85	$ 6.63	$ 11.53	$ 5.63
U.S. Merchandise Trade Balance †	Nov '85n	–$ 13.68	–$ 11.45	–$ 10.22
Plant and Equipment Expenditures*	1st Q'86	$402.13(a)	$388.98(a)	$371.16
Private Housing Starts (Thousands of Units)*	Nov '85	1,547	1,761	1,600
New Construction Expenditures*	Nov '85n	$ 348.2	$ 346.3r	$ 313.1
Total Business Inventories †	Oct '85	$ 582.0	$ 578.9	$ 568.8
Total Business Sales †	Oct '85	$ 426.3	$ 429.0	$ 414.2

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. r-Revised. a-Anticipated.

goods prices brought up to the rate experienced by services. This has not occurred for a prolonged period of time since 1979, just before the dollar reached its low point on a trade-weighted basis. But some foreign producers may not raise prices. Instead they may choose to cut into their profit margins rather than risk losing their market share to U.S. producers, making the effect of the lower-valued dollar on inflation less certain than in the past.

The dramatic slowdown in the pace of U.S. wage gains has been crucial to keeping inflation in check, since labor costs represent two-thirds of business operating costs. Average hourly earnings of nonfarm production workers increased at an extremely low pace in the third quarter of this year. This slowdown shows up in the rate of rise in the Commerce Department's index of unit labor costs. For the manufacturing sector, unit labor costs have actually fallen for two consecutive quarters, bringing the increase over the past four quarters to only 2.1 percent. The index of unit labor costs for all nonfarm business rose somewhat faster, posting a four-quarter gain of 3.3 percent. The fact that workers have been less worried about inflation and more concerned about job security has helped keep labor costs down, but this could change as 1986 unfolds and the effects of a lower-valued dollar are felt by consumers and businesses alike. H

Short Term Paper Outstanding

(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Time Deposits of $100,000 or more Weekly Reporting Banks			
Nationwide (12/18/85)	158,178	– 34	– 3,182
New York City (12/18/85)	34,440	+ 422	– 140
Commercial Paper (12/18/85)	293,161	+ 552	+54,632

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (12/18/85)	254,985	+ 855	+ 2,899
New York City (12/18/85)	58,927	– 375	– 4,808

Total Loans and Leases Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (12/18/85)	714,690	+ 9,111	+ 54,572
New York City (12/18/85)	159,014	+ 2,784	+ 9,144

Financial Markets

	Friday 1/3/86	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	7.29%	+ .11	– .76
180-Day Bills†	7.48	+ .11	– 1.12
Longest Bills†	7.63	+ .08	– 1.50
Recent Issues:			
7 7/8s 12/31/87	8.04	+ .06	
8 3/8s 12/31/89	8.41	+ .02	
9 1/2s 11/15/95	9.05	+ .07	
9 7/8s 11/15/15	9.29	+ .02	
Municipals:			
Bond Buyer–20 Bond Index* (1/2/86)	8.33%	– .03	– 1.54
Blue List Total ($ Million)	$1,780	– $335	– $ 31
30-Day Visible Supply ($ Million)	$ 537	– $499	– $1,571
Total	$2,317	– $834	– $1,602
Corporates:			
Moody's Aa Composite (1/2/86)	10.69%	+ .27	– 1.86
30-Day Visible Supply ($ Million)	$ 710	+ $ 60	+ $ 360
Stocks:			
Dow-Jones Averages:			
Industrials	1,549.20	+ 6.20	+ 364.24
Transportation	702.99	– 5.46	+ 149.96
Utilities	175.88	+ 3.79	+ 29.34
65 Stocks	616.50	+ 2.30	+ 135.57
Standard and Poor's 500 Stocks	210.88	+ 1.27	+ 47.20
N.Y.S.E. Composite Index	121.50	+ .88	+ 26.90
N.Y.S.E. Avg. Daily Vol. for Week (000's)	102,240	+19,790	+ 23,630

* 46% Taxable equivalent 15.43%.

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 1/3/86	Week Ago
Overnight	8.00%	7.81%
1 month	7.90	8.25
3 month	8.00	8.00
6 month	8.00	8.00
1 year	8.06	8.00
EURODOLLAR BONDS		
Average Yield		
Medium Term (5 to 7 yrs.)	8.85%	8.85%
Long Term (7 to 15 yrs.)	9.60	9.60

FOREIGN EXCHANGE SPOT RATES

New York Opening (1/3/86)	U.S. $ Equivalent	Currency Per U.S. $
Belgium	.01990	50.2500
Canada	.7124	1.4038
Denmark	.1116	8.9600
France	.1325	7.5450
Germany	.4062	2.4618
Italy	.0005959	1678.00
Japan	.004942	202.33
Mexico	.002286	437.50
Netherlands	.3608	2.7715
Switzerland	.4838	2.0670
U.K.	1.4445	.6923

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